As appeared in…

THE COMMUNICATION CHANNEL OF THE COMMERCIAL REAL ESTATE COMMUNITY

JULY 15-AUGUST 4, 2020

Finance

Life insurance companies are focusing on multifamily lending

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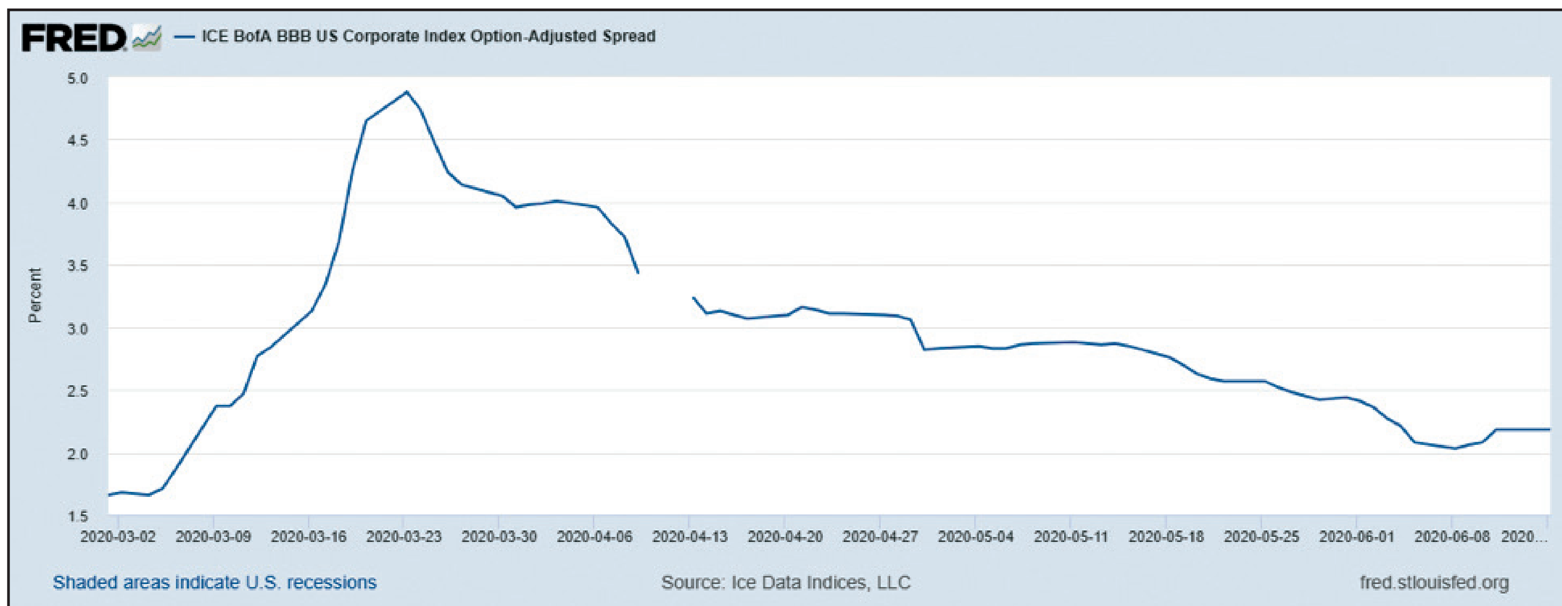
For the past 10 years or so since the Great Recession, life insurance companies have helped fuel record commercial mortgage origination, in part due to the relative value commercial mortgages were able to provide in relation to corporate bond yields. When the COVID-19 pandemic hit the U.S. in late February, extreme volatility caused liquidity in the capital markets to dry up, and corporate bond yields skyrocketed. In response, investment managers at life insurance companies shifted investment allocation away from commercial mortgages and into corporate bonds, where yields had blown out from 175 basis points to almost 500 basis points. By mid- to late March, many life insurance companies put new commercial mortgage origination on pause as they tried to determine where the new normal would shake out, and coupons went from just under 3% to over 4%.

Since the COVID-19 pandemic disrupted the capital markets in late March, life companies gradually are reentering the market. There is too much volatility and uncertainty in office and retail right now, yet lenders have to get mortgages out, so where are they going to go? The answer is into multifamily and industrial. People have to have places to live, and we are seeing that play out in how life companies are focusing on multifamily loans, and becoming increasingly aggressive to win the business. Over the past several months, the agencies have dominated the multifamily market, with headline-grabbing coupons for low-leverage loans. Life companies, which price mortgage spreads based on corporate bond yields, were effectively pushed to the sidelines. But that is changing with the Fed's late March announcement that it would start buying corporate bonds. Corporate bond spreads have tumbled since the end of March, bringing life company commercial mortgage spreads back down with them.

As spreads have compressed, and life companies are pressed to originate huge appetites into a select number of multifamily transactions on the market, we are seeing life companies competing with, and even beating, agencies on shorter-term, low-leverage transactions. Many life companies are quoting 60% leveraged, stabilized multifamily deals in the 2.75% to 3% range for five- and seven-year loans. Because the agencies securitize their mortgages, and there is a smaller secondary market for five- and seven-year paper versus 10-year paper, Fannie and Freddie's five- and seven-year coupons actually are wider than 10-year coupons. For a borrower with a shorter-term hold strategy, the life companies could provide a better alternative. Additionally, life companies can provide more prepayment flexibility to match an operator's business plan, while the agencies charge a significant premium to modify their defeasance.

The pandemic introduced a massive disruption to the lending system, but we continue to see the markets loosen up. Multifamily owners will be the first to benefit from increased competition among lenders. With corporate bond yields tumbling following the Fed's announcement, life insurance company spreads have once again tightened, and the life companies are prepared to compete with the agencies on short-term, low-leverage transactions. ▲



Federal Reserve Bank of St. Louis

The spreads between an index of all BBB-rated corporate bonds and the treasury curve.